
IN THE
Supreme Court of the United States

October Term, 1975

No. _____

75-1720

NEIL T. NAFTALIN,

Petitioner,

vs.

UNITED STATES OF AMERICA,

Respondent.

**PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT**

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TO: THE HONORABLE, THE CHIEF JUSTICE AND
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COURT OF THE UNITED STATES:

Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Eighth Circuit entered in the above action on March 30, 1976, as amended by a correcting order of April 12, 1976.

I. OPINION BELOW

The judgment of the Court of Appeals as to which review is sought was entered on March 30, 1976. It is not

yet reported and is reprinted in the Appendix, *infra*, pp. A-1 through A-10. The Court of Appeals' correcting order of April 12, 1976, is similarly not reported and is reprinted in the Appendix, *infra*, p. A-11. The judgment of the Court of Appeals reversed an unreported Memorandum Order of the United States District Court for the District of Minnesota (Appendix, *infra*, pp. A-14 through A-18), dated August 8, 1975, dismissing an indictment against petitioner. In addition, the prior, related (also unreported) order and memorandum of the District Court, dated January 24 and 28, 1975, respectively, are reprinted in the Appendix, *infra*, pp. A-19 through A-37.

II. JURISDICTIONAL STATEMENT

The judgment of the Court of Appeals was entered on March 30, 1976 (Appendix, *infra*, pp. A-1 through A-10). It was corrected, in part, by an order dated April 12, 1976 (Appendix, *infra*, p. A-11). An order staying issuance of its mandate until May 26, 1976, was issued by the Court of Appeals on April 12, 1976 (Appendix, *infra*, p. A-12). On April 29, 1976, Mr. Justice Blackmun entered an Order Extending Time to File Petition for Writ of Certiorari to and including May 28, 1976 (Appendix, *infra*, p. A-13). Jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

III. QUESTIONS PRESENTED

A. Did the Court of Appeals err in reversing the District Court and holding that the petitioner was not denied due process of law guaranteed by the Fifth Amendment to the United States Constitution, where the United States Government, without justification, delayed in bringing an

indictment against petitioner for nearly four and one-half years after the Government had full knowledge of the conduct charged in the indictment, which knowledge had been gained as a consequence of an investigation prompted by petitioner's admissions to the Government? If a finding of prejudice is necessary to sustain the dismissal of an indictment for pre-indictment delay, may sufficient prejudice to warrant dismissal be presumed under extreme circumstances of unjustified delay, as the District Court held?

B. Has the Securities and Exchange Commission violated its statutory obligations, denied the accused due process of law, and acted contrary to proper standards for the administration of criminal justice where it delayed in causing a criminal indictment to be brought against the accused for nearly four and one-half years after it had full knowledge of the facts underlying the charges in the indictment?

IV. CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

The constitutional provision involved is the language of the Fifth Amendment to the United States Constitution which states that:

No person shall * * * be deprived of life, liberty, or property without due process of law. * * *.

The statutes involved are Sections 17(a) and 20(b) of the Securities Act of 1933, as amended, 15 U.S.C. §§ 77q(a) and 77t(b) (1970), which provide as follows:

[1] 15 U.S.C. § 77q(a) (1970):

(a) It shall be unlawful for any person in the offer or sale of any securities by the use of any means or

instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

- (1) to employ any device, scheme, or artifice to defraud, or
- (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
- (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

[2] 15 U.S.C. § 77t(b) (1970):

(b) Whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the provisions of this subchapter, or of any rule or regulation prescribed under authority thereof, it may in its discretion, bring an action in any district court of the United States or United States court of any Territory, to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond. The Commission may transmit such evidence as may be available concerning such acts or practices to the Attorney General who may, in his discretion, institute the necessary criminal proceedings under this subchapter. Any such criminal proceeding may be brought either in the district wherein the transmittal of the prospectus or security complained of begins, or in the district wherein such prospectus or security is received.

V. STATEMENT OF THE CASE

Petitioner was indicted on April 11, 1974, by the Grand Jury of the United States District Court for the District of Minnesota for alleged violations of the antifraud provisions of § 17(a) of the Securities Act of 1933, 15 U.S.C. § 77q(a). The indictment charged that, in July and August 1969, as a part of a fraudulent short-selling scheme, Naftalin engineered eight separate undisclosed short sales of securities by the company in which he was the principal, Naftalin & Co., Inc., through five broker-dealer firms.

The criminal indictment was the final act in a series of proceedings involving the same transactions which were put into motion by petitioner's admission—or as the Court of Appeals puts it, "confession" (Appendix, *infra*, p. A-3)—on October 29, 1969, to officials of the Securities and Exchange Commission ("SEC") in Washington, D. C., that his company had undisclosed short sales with more than twenty broker-dealers that it was unable to complete. As the Court of Appeals stated in the opinion appealed from:

The information which Naftalin gave to the SEC at the October 29 meeting was sufficiently detailed that on the same day the SEC was able to draft a complaint for preliminary and permanent injunctive relief restraining Naftalin from further violations of the securities laws. On November 4, the complaint was filed and Naftalin consented to the preliminary injunction. (Appendix, *infra*, p. A-3.)

Immediately after gaining the preliminary injunction of November 4, 1969, the SEC commenced a broad investigation regarding the activities of the petitioner and his

company. The investigation was completed in December 1969, and as the District Court found "as of December 1969, the Chicago Regional Office of the SEC knew all of the essential facts which form the basis for the present Indictment brought in April 1974." (Appendix, *infra* p. A-15). The Court of Appeals accepted this finding. (Appendix, *infra*, p. A-3.)

Despite having full knowledge of the facts in December 1969, the SEC delayed referring the matter to the Attorney General for criminal prosecution, under 15 U.S.C. § 77t (b), until March 1974. The indictment was returned on April 11, 1974, approximately 52 months after all the facts were known.

On August 14, 1974, the petitioner requested the District Court to dismiss the indictment on a number of grounds including pre-indictment delay. On January 24, 1975, the District Court entered an order denying the motion to dismiss on all grounds except pre-indictment delay. (Appendix, *infra*, p. A-19 through A-20.) The Court reserved ruling on the pre-indictment delay claim and ordered the Government to produce its files for *in camera* inspection. On January 28, 1975, the District Court filed a memorandum relating to the January 24 order. The Court explained that it was not persuaded by Naftalin's claim of actual prejudice to his defense stemming from the death of a defense witness, but stated that it interpreted a then recent decision of the Court of Appeals for the Eighth Circuit¹ to provide that actual prejudice to one's defense need not always be shown, but may be presumed where the delay was unjustified and for an outrageous period of time. (Appendix, *infra*, pp. A-27 through A-32.)

¹*United States v. Jackson*, 504 F.2d 337 (8th Cir. 1974), *cert. denied*, 420 U.S. 964 (1975).

After further briefing, the District Court entered a Memorandum Order on August 8, 1975, dismissing the indictment for pre-indictment delay based on the Fifth Amendment's guarantee of due process of law. In reaching its inconclusion, the District Court balanced the interests of the Government and Naftalin. The District Court found that by December 1969 the SEC knew all of the facts necessary to bring an indictment, knew that Naftalin was not doing business with the public, and had obtained a preliminary injunction restraining Naftalin from violating the antifraud provisions of the 1933 and 1934 Securities Acts. This being the case, the District Court said, the SEC's expressed concern for protecting the public by thereafter successively pursuing permanent injunctive relief and administrative remedies against Naftalin could not be accorded much weight, and the delay from December 1969 until finally referring the matter to the Justice Department for criminal prosecution was completely unjustified. The District Court further found that, in contrast, Naftalin suffered from the delay in two ways:

* * * He has been inhibited in offering mitigating testimony at the administrative proceedings. He has had to live for four and one-half years after admission of wrongdoing under uncertainty as to whether he would be criminally prosecuted. This latter injury should not be underestimated. The criminal law has a strong concern for finality and repose, as reflected in the rules governing speedy trial and double jeopardy. (Appendix, *infra*, p. A-16.)

The Government appealed the dismissal of the indictment to the Court of Appeals pursuant to 18 U.S.C. § 3731 (1970). The Court of Appeals reversed the Dis-

strict Court's dismissal and ordered that the indictment be reinstated. It held that unreasonable and unjustified delay in bringing an indictment standing alone does not violate the due process clause of the Constitution. It held that in addition to delay, the accused must demonstrate (1) actual prejudice to his ability to defend himself, or (2) that the Government's delaying conduct was intentional and for the purpose of gaining a tactical advantage over the defendant. The Court further held that the prejudice to the petitioner found by the District Court—*i.e.*, the inhibition to petitioner's offering mitigating testimony at administrative proceedings and having had to live for four and one-half years after admission of wrongdoing under uncertainty as to criminal prosecution—was not sufficient "to invoke the due process guarantee against prejudicial delay." (Appendix, *infra*, p. A-8.) Finally, the Court found that the petitioner had not established that the Government intentionally employed the delay for tactical advantage.²

The Government's Enforcement Pattern in this Case.

The Government took the position below that its four and one-half year delay in this case was justified because the SEC's "customary" enforcement policy had been employed. That policy, it said, is one of proceeding consecutively from a civil injunctive action, to administrative proceedings, and finally, to criminal prosecution. The District Court found that such an enforcement pattern was wholly inappropriate in this case, where the petitioner admitted his conduct to the SEC more than four and one-half years prior to indictment; where the SEC's investigation was com-

²In view of its finding of outrageous, unjustified delay, the District Court had not reached the latter question.

pleted, and the SEC had the facts in its possession, nearly four and one-half years prior to indictment; and where the Government had not proceeded expeditiously at any stage, from and after the time it obtained preliminary injunctive relief. The Court of Appeals, on the other hand, placed its imprimatur on such a practice. (Appendix, *infra*, A-9 through A-10.)

The proceedings which the Government claims justified the SEC's delay in referring the instant matter for criminal prosecution are as follows:

(1) *Civil injunctive action (November 1969-August 1972).* The SEC caused a civil action for injunctive relief to be filed on November 4, 1969, based in part on the same transactions alleged in the present indictment.³ A preliminary injunction restraining Naftalin and his company from violating the securities laws was entered by consent on the same day.

On December 23, 1969, the SEC secured the appointment of a receiver for the petitioner's company, to marshal the remaining assets. The Receiver thereafter assumed his duties and retained private counsel to assist him, with only minimal participation by the SEC.⁴

In all other respects, the injunctive action was virtually dormant until August 29, 1972, when it was concluded by replacing the preliminary injunction with a permanent injunction, also entered on stipulated facts, and with the petitioner's consent.

³*SEC v. Naftalin & Co., Inc., et al.*, 4-69 Civil 385 (D. Minn., Nov. 4, 1969).

⁴An appeal arising out of Naftalin's failure to comply with a court order to deposit certain bonds with the clerk of court, and a contempt citation in connection therewith, ensued, *SEC v. Naftalin*, 460 F.2d 471 (8th Cir. 1972). The Receiver's private counsel represented the SEC, the named appellee, on the appeal.

(2) *Bankruptcy proceedings (February 1970—November 1972)*. Two separate petitions for involuntary bankruptcy proceedings were filed on February 10 and February 18, 1970, against Naftalin's company by two groups of broker-dealers with whom the petitioner had initiated uncompleted short sales.⁵ The claims made by the broker-dealers in those proceedings incorporate the transactions which form the basis for seven of the eight counts in the present indictment.

While the SEC was not a party to the bankruptcy proceedings, the record overwhelmingly demonstrates that it closely monitored them.⁶ Indeed, it is clear from the SEC's internal memoranda that a substantial portion of the SEC's delay in pursuing permanent relief in the injunctive action, in deferring the commencement of its administrative proceeding, and ultimately in obtaining the indictment challenged herein, was attributable to the SEC's close observance of the bankruptcy proceedings, to which it was not a party, but in which it anticipated success by the broker-dealers in their claims against the petitioner's company.

Ultimately, during 1972, when the broker-dealers were compelled to appeal an adverse ruling on their claims entered by the District Court in September 1971, the SEC filed an amicus curiae brief in the Eighth Circuit, address-

⁵*In Re Naftalin & Co.*, 4-70 Bky. 137, 170 (D. Minn., Feb. 10, 18, 1970); 315 F.Supp. 463 (D. Minn. 1970); 333 F.Supp. 136 (D. Minn. 1971); and 469 F.2d 1166 (8th Cir. 1972).

⁶The broker-dealers also instituted a number of 10b-5 cases against Naftalin based on the same transactions which are the subject of the indictment. *H. S. Kipnis & Co., et al. v. Naftalin & Co., Inc., et al.*, 4-70 Civil 408 (D. Minn. Oct. 1, 1970); *Merrill Lynch, et al. v. Naftalin & Co., Inc., et al.*, 4-70 Civil 458 (D. Minn. Oct. 23, 1970); *Faulkner, Dawkins & Sullivan v. Naftalin & Co., Inc., et al.*, 4-71 Civil 33 (D. Minn. Jan. 29, 1971). The SEC also closely monitored these proceedings.

sing itself, *inter alia*, to the same transactions upon which the present indictment is based.⁷

(3) *Administrative proceedings (September 1971-June 1973)*. Although it is clear from the SEC's files that it contemplated the commencement of administrative proceedings against the petitioner, based upon the same transactions alleged in the present indictment, as early as March 1970,⁸ the proceedings were not formally commenced until September 30, 1971, one week after the District Court's decision adverse to the broker-dealers in the bankruptcy proceedings. *In Re Naftalin & Co., Inc.*, 333 F. Supp. 136 (D. Minn. 1971).

In the administrative proceedings, the SEC sought to revoke the broker-dealer license of Naftalin & Co., and to bar the petitioner from ever being associated with a broker-dealer. In October and December 1971, counsel for Naftalin and his company made two formal offers of settlement to the SEC. Both offers provided for the revocation of Naftalin & Co.'s broker-dealer registration, but proposed limited (first one, and then two, year) suspensions of the petitioner from the securities industry. The offers were rejected by the SEC, the second on January 13, 1972.

Hearings were held before an administrative law judge in November 1972, and briefs were filed in January and March 1973. In its briefs, the SEC sought to bar the petitioner from the industry for life, and, in support of its

⁷*In Re Naftalin & Co.*, 469 F.2d 1166 (8th Cir. 1972). The Eighth Circuit, for the most part, affirmed the District Court's determination and remanded the case for further proceedings. Those proceedings are not yet completed.

⁸The SEC tendered an offer of settlement of "anticipated" proceedings to the petitioner and his company in March 1970, proposing the petitioner's lifetime bar from the securities industry. In August 1970, the SEC drafted an order for private administrative proceedings, but did not finalize it.

arguments, repeatedly commented on the petitioner's failure to testify in his own defense at the hearing.

On May 17, 1973, the administrative law judge entered a decision barring Naftalin from the securities industry until such time as he might be reinstated consistent with the public interest. No appeal was taken, and the decision became final on June 19, 1973.

Only then, in June 1973, despite the fact that its files reveal that the SEC had a death grip on the prospect of prosecuting the petitioner criminally at least as early as September 1971,⁹ did the SEC's Chicago Regional Office begin the preparation of a criminal reference report. And even then, the criminal reference report was not complete at the end of December 1973. Ultimately, in lieu of preparing the report, and in order to avoid the expiration of the five year statute of limitations, the Chicago Regional Office employed the last-ditch procedure of contacting the United States Attorney for the District of Minnesota and asking him to request the Naftalin files from the Commission for prosecution. The Regional Office subsequently drafted a proposed indictment, and transmitted it to the United States Attorney in Minnesota in March 1974. The indictment was filed on April 11, 1974.

⁹The SEC's internal memoranda, made a part of the record in the District Court, reveal that the Chief of the Enforcement Branch of the SEC's Chicago Regional Office noted in his Investigation Progress Report for the quarter ending September 30, 1971, that he was "presently reviewing transcripts and other material with a view to recommending criminal proceedings." In another internal memorandum authored by the same SEC attorney on December 8, 1971, recommending the Commission's rejection of the petitioner's second settlement offer in the administrative proceeding, the SEC gave further insight into its own views concerning the prospects of subsequent prosecution: "We believe that the facts recited hereinafter disclose such willful, flagrant, fraudulent conduct by the respondents that the arguments of Socrates could not persuade this Commission from finding that any sanction short of revocation for the respondent Naftalin & Co., Inc., and a bar from ever being associated with a broker-dealer for respondent Neil T. Naftalin would be appropriate."

VI. REASONS FOR GRANTING THE WRIT

A. Certiorari should be granted to decide the question of whether due process was violated where the Government, without justification, delayed in bringing an indictment against petitioner for nearly four and one-half years after it had full knowledge of the conduct charged, which knowledge had been gained as a consequence of an investigation prompted by the petitioner's admissions to the Government.

The proposition is well established that the statute of limitations does not fully define the rights of criminal suspects to be speedily accused. *United States v. Marion*, 404 U.S. 307, 324 (1971). Basic procedural fairness requires that prosecutors do more than merely act within the statute of limitations period. Determining how much more, and when, involves "a delicate judgment based on the circumstances of each case." *Id.*, at 325. Here the trier of fact, the District Court, concluded that the Government's delay was unjustified and unreasonable, and that the harm suffered by petitioner was sufficiently significant as to warrant dismissal of the indictment against him.

It is fundamentally unfair for a prosecuting attorney, *once in possession of the facts*, to delay the institution of criminal proceedings for *years*, even for reasons otherwise defensible from a law enforcement standpoint. This basic unfairness is greatly magnified when, as the District Court found, the delay was totally unjustified and indefensible.

We submit, as the District Court held, that nearly four and one-half years of unjustified delay alone, without a specific showing by the accused that his ability to defend himself has been impaired by the delay or that the Government

employed the delay to gain a tactical advantage, is sufficient to compel dismissal of the indictment for violation of the petitioner's right to due process. We believe that the balancing of interests test utilized by the District Court is the appropriate manner in which to determine whether an accused has been denied due process as a result of pre-indictment delay. Finally, we contend that where the scales are tipped in the manner found by the District Court here [*i. e.*, no justification for the Government's delay, as contrasted with the petitioner's being inhibited from offering mitigating testimony in administrative proceedings which ultimately deprived him of his livelihood, and his being required to live under uncertainty as to whether he would be prosecuted for more than four and one-half years following disclosure of the facts to the SEC] due process has been denied. In short, if "prejudice" need be shown it should be presumed as a matter of law under what the District Court found to be outrageous circumstances.

This is not a case where the Government had to ferret out concealed information. Rather, the facts on which the Government bases its indictment came to it in a cloudburst on October 29, 1969, at the petitioner's instance, and have rained continuously in one legal proceeding after another ever since. As District Judge Earl R. Larson stated in dismissing the indictment:

* * * Congress in drafting the limitations standard [five years] presumably gave considerable weight to the complexity of securities fraud and the lengthy investigation often required to uncover wrongdoing. It could hardly have contemplated a case like the present in which the defendant publicly admitted the wrongful activity before any investigation had commenced. * * * (Appendix, *infra*, p. A-16.)

Nor is this a case in which the Government was required to uncover conspirators; protect witnesses; shoot for bigger game; or any of the other considerations traditionally associated with the defensible biding of time by enforcement agencies. The Government obtained the information, and, for reasons which, whatever else they have may been, were unrelated to crime detection or prevention, elected to defer prosecution indefinitely.

Very simply, the Government had no legitimate reason for delaying this prosecution for four and one-half years. Nor did it claim any justification, other than what it terms the customary policy of the SEC to pursue injunctive actions, administrative proceedings, and criminal prosecution, in consecutive fashion, to "protect the public". The sanctity of that manner of proceeding was rejected by the District Court as being clearly inapplicable where the SEC has full possession of the facts at an early date, as it undeniably had here. We believe that the procedure itself violates due process as is discussed *infra*.

The Court of Appeals' reversal of the District Court's holding in this matter has resulted in this Petition. We believe that the question presented has not previously been decided by this Court and is of sufficient constitutional importance that this Court should grant a writ of certiorari to review the Court of Appeals' decision.

B. The Securities and Exchange Commission's enforcement practice of pursuing civil and administrative remedies prior to referring for criminal prosecution is contrary to statute, denies an accused due process of law, and is so fundamentally unfair and contrary to proper standards for administration of criminal justice that this Court should prohibit it by exercise of its supervisory powers, particularly where the accused had admitted the conduct charged as wrongdoing in the indictment to the Securities and Exchange Commission, and the Securities and Exchange Commission had completed its investigation, nearly four and one-half years prior to indictment.

The Government argued in the lower courts that its delay in seeking an indictment was justified by the "fact" that it had followed its customary policy of pursuing civil and administrative remedies before referring the matter for criminal prosecution. The District Court found, and the Court of Appeals agreed, that in December 1969, the SEC had all of the necessary information which formed the basis for the indictment of petitioner in April 1974, some 52 months later. The District Court found that the Government's reliance on the "customary enforcement policy" as justification for the pre-indictment delay was not a legitimate reason for delay under the circumstances present in this case. Those circumstances include the petitioner's admission of his conduct to the SEC, prior to any investigation; full possession by the SEC of all essential facts nearly four and one-half years prior to indictment; and the absence of any need for delay on the SEC's part to protect the investing public, once preliminary injunctive relief had been obtained and the petitioner was no longer engaged

in business. The Court of Appeals, on the other hand, gave its stamp of approval to a governmental agency's leisurely pursuit of its "customary" enforcement policy, without regard to the underlying circumstances.¹⁰

The District Court correctly observed that the Securities Act of 1933, in particular 15 U.S.C. § 77t(b), gives the SEC responsibility for pursuing prompt injunctive and administrative remedies against broker-dealer violations in order to protect the trading public and to maintain the integrity of the securities markets. The District Court also recognized that "a requirement that institution of a civil or administrative action constitutes a waiver of all subsequent criminal prosecution would 'stultify enforcement of federal law'. *United States v. Kordel*, 397 U.S. 1, 11 (1970)." (Appendix, *infra*, pp. A-16 through A-17.)

We submit that the SEC could and should have referred the instant matter to the Attorney General, at the latest, in December of 1969. We believe that the District Court's interpretation of the intent of the statute governing referrals, 15 U.S.C. § 77t(b), as requiring prompt referral to the Attorney General of matters in which the SEC envisions possible criminal prosecution is correct, (Appendix, *infra*, p. A-17, n. 1), and that failure to promptly refer un-

¹⁰In so holding, the Court of Appeals charitably commented that the "wheels of government ground with agonizing slowness." Appendix, *infra*, p. A-9. A truer characterization of the delay of the SEC in causing a criminal prosecution to be brought is that it was "unjustified" and "legitimate reasons which the SEC has for delaying a criminal reference to the Justice Department have been 'stretched to the breaking point'" as the District Court found. Appendix, *infra*, p. A-18. There was absolutely no need for the delay present here. Had the SEC proceeded promptly with the civil and administrative matters, deference to its claimed customary policy might have some merit. However, the SEC did not act promptly. Rather, it is evident from the record that the SEC proceeded at a snail's pace, without any justification.

der circumstances like the present requires dismissal of the indictment as being contrary to the intent of the statute.¹¹ The Court of Appeals dismissed this contention by responding, in effect, that the procedure followed in this case was satisfactory because ultimately the Attorney General may decide not to prosecute if the civil and administrative penalties imposed are deemed sufficient. That reasoning misses the mark. The statute leaves the decision whether to prosecute with the Attorney General. Whenever the SEC feels that criminal proceedings may be warranted, the Attorney General should promptly be informed of the information in the SEC's possession so that discretion as to prosecution may be timely exercised by the party with the authority. Then, the accused may either be promptly removed from the public arena if guilty, or allowed to live a normal life if exonerated. By delaying the criminal reference for an unreasonable period of time after gaining knowledge of the underlying circumstances, the SEC deprived the Attorney General of the appropriate, timely opportunity to exercise his discretion, and deprived the petitioner of a fundamental procedural fairness.

We also believe that the Government's attempt, and the Court of Appeals' acceptance thereof, to justify the delay on the ground that the SEC followed its customary en-

¹¹The District Court reasoned that: "The next to the last sentence of the subsection is of particular interest here. ['The Commission may transmit such evidence as may be available concerning such acts or practices to the Attorney General who may, in his discretion, institute the necessary criminal proceedings under this subchapter.'] Although not without ambiguity, the words 'such evidence as may be available' indicate a Congressional intent (1) that if it envisions possible criminal prosecution, the S.E.C. promptly refer the matter to the Justice Department, and (2) that the Justice Department continue the investigation. The S.E.C.'s delay of over four years in referring the present matter to the Justice Department violates the apparent intent of § 77(t)(b)." Appendix, *infra*, p. A-17 n. 1.

forcement policy should be reviewed by this Court. This practice allowed the SEC to whipsaw the petitioner by inhibiting him from offering mitigating testimony in the administrative proceedings. Indeed, in briefs submitted to the administrative law judge, the SEC repeatedly commented on the failure of the petitioner to testify on his own behalf in those proceedings. Had the petitioner chosen to testify in the administrative proceedings, then the Government, of course, would have postured itself for an attempt to use that testimony against him in the criminal proceedings. Had the criminal proceedings been referred to the Government in December 1969, or promptly thereafter, the SEC would not have been able to manipulate the petitioner as it has done. Moreover, as the District Court found, the delay in bringing the criminal prosecution for over four and one-half years after the petitioner's admission to the SEC of conduct charged as wrongdoing herein has caused the petitioner to live under continual uncertainty as to whether he would be criminally prosecuted. The District Court correctly held that placing these burdens on the petitioner, without justification on the Government's behalf, denied the petitioner due process of law and compelled dismissal of the indictment. This Court should review the Court of Appeals reversal of that holding.

Finally, in the event that this Court is not convinced that review of the Court of Appeals' *carte blanche* approval of the customary enforcement policy of the SEC is justified as being contrary to statutory law or the due process clause of the Fifth Amendment, the Court should grant this petition to determine whether the SEC's customary procedure is so unfair and contrary to proper standards for administration of criminal justice as to warrant the exercise

of this Court's supervisory powers. In support of granting certiorari on this ground, we submit that it is grossly unfair to require an accused to live under a cloud of uncertainty as to prosecution for over four and one-half years after the accused has admitted his conduct to the SEC where the only justification for delay is the hollow one that the government agency followed its customary policy. The District Court correctly pointed out that the SEC's and the Government's conduct herein is completely contrary to the concern of the criminal law "for finality and repose, as reflected in rules governing speedy trial and double jeopardy." (Appendix, *infra*, p. A-16.)

We also believe that Congress's concern that prompt disposition be made of criminal matters as expressed in the Speedy Trial Act of 1974, 18 U.S.C.A. §§3161-74 (1976 Pocket Part) [Pub.L. No. 93-619, Title I, § 101 (Jan. 3, 1975)], is thwarted by judicial approval of the SEC's four and one-half year delay between gaining knowledge of all the facts and seeking an indictment, justified solely on the basis that the SEC has followed its "customary enforcement policy". We recognize that the Speedy Trial Act of 1974 does not by its express terms come into play until the accused is charged with an offense. Nonetheless, we submit that permitting a government agency to delay criminal prosecution without sound justification for nearly four-and one-half years after the agency is in possession of all the facts is contrary to the purpose and spirit of the Act. Accordingly, we ask this Court to review this question and exercise its supervisory powers to put a stop to this practice of the SEC by reversing the Court of Appeals and ordering dismissal of the indictment against the petitioner.

VII. CONCLUSION

Wherefore, the petitioner prays that a writ of certiorari be issued to review the judgment of the United States Court of Appeals for the Eighth Circuit in this matter.

Respectfully submitted,

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A-1

APPENDIX

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No. 75-1692

United States of America,

Appellant,

vs.

Neil T. Naftalin,

Appellee.

Appeal from the United States District Court
for the District of Minnesota

Submitted: December 9, 1975

Filed: March 30, 1976

Before LAY, BRIGHT, and HENLEY, Circuit Judges

BRIGHT, Circuit Judge

This is an appeal by the United States from an order entered by District Judge Earl R. Larson dismissing an indictment against Neil T. Naftalin. The order of dismissal, entered August 8, 1975, was based upon a finding of out-

rageous delay in bringing criminal charges. The dismissed indictment charged eight counts of securities fraud perpetrated during the summer and fall of 1969.

Naftalin's alleged fraud is explained in detail in a prior opinion of this court. *Naftalin & Co., Inc. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 469 F. 2d 1166 (8th Cir. 1972). Basically, Naftalin, through his corporation, is accused of fraudulently selling stock which he did not own.¹ When he felt that a particular stock had reached a peak market price, he would place orders to sell shares of that stock with brokers/dealers to whom he was known. Because of his reputation in the securities industry, he was able to delay actual delivery of the stock for some time. If things worked as he planned, the market price would decline after his sale. He would then purchase the stock at the reduced price to cover his previous sale. Unfortunately for Naftalin, in 1969, he made major sales of stock which promptly increased sharply in price. He was unable to cover his obligations and realized that his scheme would inevitably be exposed in short order.

On October 27, 1969, Naftalin held a meeting with broker/dealers who were victims of his scheme. He explained his system of operation to them and informed them that he would not be able to honor his commitments. On

¹Naftalin's scheme, known colloquially as "free riding" must be distinguished from a legitimate "short sale," in which the purchaser is aware that the seller does not presently own the stock sold for future delivery. The indictment charges that Naftalin expressly and fraudulently claimed to have actual present ownership.

Naftalin was president and 80 percent shareholder in Naftalin & Co. During the entire period in question, Naftalin & Co. "operated as a one-man business with Neil Naftalin conducting all of its affairs." *Naftalin & Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, *supra*, 469 F.2d at 1170-71. For purposes of this opinion, it is generally unnecessary to distinguish between Naftalin and his company.

October 29, 1969, he met with the Securities and Exchange Commission (SEC) in their Washington, D.C. offices. The Chicago regional director was present at that meeting. During the meeting he outlined his activities and indicated that he was not going to be able to cover his obligations.

The information which Naftalin gave to the SEC at the October 29 meeting was sufficiently detailed that on the same day the SEC was able to draft a complaint for preliminary and permanent injunctive relief restraining Naftalin from further violations of the securities laws. On November 4, the complaint was filed and Naftalin consented to the preliminary injunction.

As of November 25, the SEC began further investigation of the situation. It sent questionnaires to the various broker/dealers who Naftalin had identified as being involved and received written responses. Also, Naftalin's books were audited and other channels of investigation were pursued. The district court found that as of December 1969, the SEC knew all of the essential facts underlying the eight count indictment which was finally returned against Naftalin. The Government does not seriously contest this finding and we accept it.

During the period between Naftalin's initial confession and the bringing of the criminal indictment, there were four major areas of activity in which the SEC participated to a greater or lesser degree. These areas of activity, in order of the date of initiation, were:

- 1) SEC proceedings for a preliminary and permanent injunction.
- 2) SEC initiated receivership of the assets of Naftalin & Co. including resolution of a contempt citation arising

from Naftalin's refusal to surrender \$590,000 in United States Bonds purchased with proceeds of his securities dealings. See SEC v. Naftalin, 460 F. 2d 471 (8th Cir. 1972.)

3) Involuntary bankruptcy proceedings brought by two groups of broker/dealers victimized by Naftalin. See Naftalin & Co., Inc. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., supra; In re Naftalin & Co., Inc., 333 F. Supp. 136 (D. Minn. 1971); In re Naftalin & Co., Inc., 315 F. Supp. 463 (D. Minn. 1970).

4) SEC administrative proceedings brought for the purpose of barring Naftalin from the securities industry for life.

The administrative proceedings culminated in an administrative order barring Naftalin from the securities industry for life which became final on June 19, 1973. Other civil proceedings also had been substantially concluded by that date.

Unfortunately, the SEC did not refer the matter to the Justice Department for prosecution until March 8, 1974, some nine months later, and an indictment was not returned until April 11, 1974. Thus, the indictment was within the five-year period set by the statute of limitations, 18 U.S.C. §3282, by only a few months, and follows by nearly four and one-half years the time at which the Government possessed essentially all of the facts upon which the indictment was based. Had the prosecutor not acted with commendable dispatch, this entire prosecution would have been stillborn.

The district court found that this four and one-half year delay between the time of full governmental knowledge and

the bringing of a criminal indictment was outrageous. Although unable to identify any demonstrable prejudice to Naftalin's defense, the court, relying upon language from a footnote in United States v. Jackson, 504 F. 2d 337, 339 n.2 (8th Cir. 1974), cert. denied, 420 U.S. 964 (1975), found the delay sufficiently aggravated to be considered presumptively prejudicial. As a result, the court held that due process precluded the Government from proceeding with the prosecution.

The Government contends that most of this delay was reasonable, although at oral argument counsel conceded that at least nine months of the delay were unnecessary. The Government further argues that in the pre-accusatory context, delay within the statute of limitations will not bar a criminal prosecution unless either there is specific demonstrable prejudice to the defendant's ability to defend himself or the Government's conduct was intentional and for the purpose of gaining a tactical advantage over the defendant.

This court has recently discussed at some length the standards for assessing claims of pre-accusatory delay. See United States v. Barket,—F. 2d—, No. 75-1320 (8th Cir., Jan 28, 1976). There we said the determination of such a claim

involves "a process of balancing the reasonableness of the delay against any resultant prejudice to the defendant." The test for determining prejudicial impact is whether the delay "has impaired the defendant's ability to defend himself," and the trial court's finding on the prejudice issue must stand unless clearly erroneous. [Slip op. at 7 (emphasis added, citations omitted).]

Barket emphasizes that prejudice to the accused's ability to defend against the charges made in the indictment is a sine qua non of a valid claim of pre-accusatory delay. If such prejudice is found, it must be balanced against the reasonableness of delay. But absent such prejudice, the reasonableness of the delay becomes irrelevant. Of course, as we discuss below, the necessary prejudice may sometimes be presumed.

The classic type of prejudice is the death or unavailability of a material witness. In Barket, the court found that during the 47 month delay, "six material witnesses had died and others had faded memories of events crucial to Barket's defense." *Id.* at 5; cf. United States v. Lovasco, —F. 2d—, No. 75-1852 (8th Cir., Feb.—, 1976). Although Naftalin makes a claim that an important witness has died, the district court found that, assuming the relevance of the alleged witness' testimony, his dealings with Naftalin could be established from his and Naftalin's records and that his death therefore did not cause substantial prejudice.

Undeniably, as the delay increases, the specificity with which prejudice must appear, diminishes. Particularly in cases hinging on identification by one or few eyewitnesses, delay raises a "lurking danger of misidentification." Robinson v. United States, 459 F. 2d 847, 853 (D. C. Cir. 1972). Also, the inability of the accused to recall his conduct on an unremarkable day in the distant past may bar prosecution in some cases.² For example,

²A very recent District of Columbia Circuit case suggests that prejudice may sometimes be found where extreme delay raises a general likelihood of inaccuracy in the Government's case. United States v. Jones, —F.2d—, 18 Cr.L. 2347 (D.C. Cir., Jan. 21, 1976). This seems to be a more general formulation of the court's concern about misidentification just discussed. We perceive no such likelihood of inaccuracy here.

[t]he people [in the drug subculture] simply do not have desk pads and social calendars to assist them in determining where they were at a particular time many months before. [Powell v. United States, 352 F. 2d 705, 711 (D.C. Cir. 1965), quoted in Robinson v. United States, supra, 459 F. 2d at 852 n. 31.]

Here the situation is quite different. The Government correctly points out that the securities industry is characterized by records kept in duplicate and triplicate. As the district court noted, because of these extensive records, the memories of witnesses are not as crucial as in other types of cases. Further, the early initiation of civil and administrative proceedings in this case served to draw early attention to Naftalin's affairs. Both the SEC and Naftalin contacted witnesses and recorded their statements at an early date. Thus, it is unlikely that Naftalin's defense will be genuinely hindered by faded memories.

The district court did find two areas of specific prejudice. The court found that Naftalin

has been inhibited in offering mitigating testimony at the administrative proceedings. He has had to live for four and one-half years after admission of wrongdoing under uncertainty as to whether he would be criminally prosecuted.

However, as we have previously observed, only prejudice to an accused's ability to defend against the indictment will support a due process attack on pre-accusatory delay. As the Government correctly points out, if Naftalin was denied due process in the administrative proceeding, that is where the issue should have been raised and de-

cided. And while the burden of uncertainty is an important constitutional consideration in determining whether the sixth amendment right to a speedy trial has been impaired by an undue delay between accusation and trial, it has not been held to be prejudice of constitutional magnitude in assessing pre-accusatory delay, though it may properly be considered in assessing reasonableness. See United States v. Marion, 404 U.S. 307, 320-22 (1971).

Thus, the only prejudice which the district court was able to identify after carefully examining the record is insufficient to invoke the due process guarantee against prejudicial delay.

It is true that in United States v. Jackson, *supra*, we did suggest in a footnote that in certain extreme cases prejudice might be presumed. Our precise language was as follows:

[W]e hesitate to say that prejudice could never be presumed in an outrageous case of unjustified delay. We agree that, at least where the government is not engaging in intentional delay in order to gain a tactical advantage over the accused, the defendant must affirmatively demonstrate prejudice. [504 F. 2d at 339 n.2 (citations omitted).]

It is clear that this language was not intended to elevate the subjective term "outrageous" to the status of an independent test. Instead, as the cases cited make clear, the term "outrageous" was employed to describe deliberate and ill-motivated attempts by the Government to weaken the accused's defense by long delay. See United States v. Golden, 436 F. 2d 941, 945 (8th Cir.), *cert. denied*, 404 U.S. 910 (1971); Terlikowski v. United States, 379 F. 2d

501, 505 (8th Cir.), *cert. denied*, 389 U.S. 1008 (1967).

We have carefully reviewed the history of this case, and while it is clear that the wheels of government ground with agonizing slowness, we cannot say that the Government engaged in any intentional ill-motivated delay for the purpose of weakening Naftalin's defense. The district court found only that

the S.E.C.'s customary enforcement policy is to proceed consecutively from injunctive action, to administrative proceedings, to criminal prosecution [and] that in the Naftalin matter initiation of the administrative proceedings was not pursued with any vigor during 1970 and the first eight months of 1971 because of involuntary bankruptcy proceedings pending against Naftalin & Company * * *.

* * *

However innocent or inadvertent the delay in bringing this prosecution may have been, it was clearly without justification.

The SEC's practice of exhausting civil and administrative proceedings before recommending criminal prosecution has been recognized by other courts and held not per se unreasonable. See United States v. Benson, 487 F. 2d 978 (3rd Cir. 1973); United States v. Dukow, 453 F. 2d 1328 (3d Cir.), *cert. denied*, 406 U.S. 945 (1972). The securities laws are complex and easily violated. The public interest may not always call for criminal prosecution, particularly where effective civil and administrative remedies have been obtained. For that reason, Congress appears to have sanctioned the completion of civil remedies by the

SEC after which it may transmit evidence which it has discovered to the Attorney General for criminal prosecution at his discretion. See 15 U.S.C. §77t(b); see generally SEC v. Collier & Co., 76 F. 2d 939 (2d Cir. 1939). Certainly, there is little to be said for forcing the SEC into hastily referring incomplete files to the Attorney General. If referrals are postponed until the civil and administrative proceedings are complete, in many cases the Attorney General may be able to determine that the noncriminal proceedings have provided adequate sanctions and therefore that the public interest does not require a criminal prosecution. Cf. United States v. Benson, supra, 487 F. 2d at 986.

In sum, we conclude that this record discloses no basis or finding that Naftalin will be prejudiced in making his defense at trial. The absence of such prejudice is fatal to Naftalin's due process claim. Therefore, the district court's order of dismissal is hereby reversed and the case is remanded with instructions to the district court to reinstate the indictment.

HENLEY, Circuit Judge, concurring:

Since it is clear both that the Government has engaged in no ill-motivated delay for the purpose of weakening the defense and that the record discloses no basis for finding that the defendant will be prejudiced in making his defense, on authority of United States v. Marion, 404 U.S. 307 (1971), without more I concur in the result reached by the court.

A true copy.

Attest:

Clerk, U. S. Court of Appeals, Eighth Circuit

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

September Term, 1975

75-1692

The United States,

Appellant,

vs.

Neil T. Naftalin,

Appellee.

Appeal from the United States District Court
for the District of Minnesota

The top four lines of page 4 of the slip opinion in this case dated March 30, 1976, following subparagraph 4) are corrected to read:

The administrative proceedings culminated on June 19, 1973, in an administrative order barring Naftalin from the securities industry until such time as he might be reinstated, consistent with the public interest. Other civil proceedings also had been substantially concluded by that date.

April 12, 1976.

A-12

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

September Term, 1975

No. 75-1692

The United States,

Appellant,

vs.

Neil T. Naftalin,

Appellee.

On motion of Appellee, it is now here ordered that the issuance of the mandate herein be, and the same is hereby, stayed for a period of thirty days from this date. If within that time there is filed with the Clerk of this Court a certificate of the Clerk of the Supreme Court of the United States that a petition for writ of certiorari has been filed, the stay hereby granted shall continue until the final disposition of the case by the Supreme Court.

April 26, 1976.

A-13

SUPREME COURT OF THE UNITED STATES

No. A-947

Neil T. Naftalin,

Petitioner,

vs.

United States

Order Extending Time to File Petition For
Writ of Certiorari

UPON CONSIDERATION of the application of counsel for petitioner(s),

IT IS ORDERED that the time for filing a petition for writ of certiorari in the above-entitled cause be, and the same is hereby, extended to and including May 28, 1976.

Dated this 29th day of April, 1976.

/s/ Harry A. Blackmun
Associate Justice of the Supreme
Court of the United States

UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA
FOURTH DIVISION

United States of America,

Plaintiff,

vs.

Neil T. Naftalin,

Defendant.

Memorandum Order

No. 4-74-Cr. 73

Defendant has been charged in an eight count Indictment with violating the Securities Act of 1933 through a short sale scheme in which defendant fraudulently represented to broker/dealers that he owned the securities he was selling short. The offenses charged took place in the late summer and early fall of 1969.

Defendant admitted the essential facts of his scheme at a conference with over twenty broker/dealers held in New York City on October 27, 1969. Two days later he described his transactions to Securities and Exchange Commission officials in Washington. The S.E.C. obtained a preliminary injunction against further violations by defendant of the anti-fraud provisions of the 1933 and 1934 Securities Acts on November 4, 1969. During November and December 1969 the S.E.C. circulated questionnaires to the broker/dealers who defendant had allegedly defrauded. An S.E.C. investigator examined Naftalin & Company's books

in early December 1969. A receiver for the Company was appointed on December 23, 1969. As of December 1969 the Chicago Regional Office of the S.E.C. knew all of the essential facts which form the basis of the present Indictment brought in April 1974. The Chicago Regional Office also knew that Naftalin did not do business with the public, but only traded for his own account.

Defendant seeks dismissal of the Indictment because of "outrageous and unjustified" pre-indictment delay and delay designed to obtain a tactical advantage. In its Order of January 24, 1975, and Memorandum of January 28, 1975, the Court ruled that defendant had made a sufficient showing to require in camera inspection of the S.E.C. files on this prosecution. The pertinent files of the Chicago Regional Office were produced for the Court, and the Government voluntarily allowed inspection of the files by defendant's counsel. Testimony of several officials from the Chicago Regional Office who have been involved in the case was heard on April 24 and 25, 1975. That testimony and examination of the S.E.C. files show that the S.E.C.'s customary enforcement policy is to proceed consecutively from injunctive action, to administrative proceedings, to criminal prosecution; that in the Naftalin matter initiation of the administrative proceedings was not pursued with any vigor during 1970 and the first eight months of 1971 because of involuntary bankruptcy proceedings pending against Naftalin & Company; that administrative proceedings concluded on May 17, 1973, and approximately eight months later S.E.C. Attorney Bernstein called the United States Attorney's Office in Minneapolis to recommend prompt initiation of criminal prosecution before the running of the 5-year statute of limitations.

As discussed in the Court's January 28 Memorandum, United States v. Jackson, 504 F.2d 337 (8th Cir. 1974), suggests that pre-indictment delay without a showing of substantial prejudice may be so unreasonable as to constitute a violation of due process. This Circuit differs on this point from other Circuits which have ruled that the statute of limitations is the sole control on delay between commission of an offense and indictment. See United States v. Dukow, 453 F.2d 1328 (6th Cir. 1972). The balancing of interests suggested in Jackson seems a better rule than strict application of the limitations standard. Congress in drafting the limitations standard presumably gave considerable weight to the complexity of securities fraud and the lengthy investigation often required to uncover wrongdoing. It could hardly have contemplated a case like the present in which the defendant publicly admitted the wrongful activity before any investigation had commenced. The Court must inquire further into the interests at stake on both sides.

Defendant has suffered from the delay in two ways. He has been inhibited in offering mitigating testimony at the administrative proceedings. He has had to live for four and one-half years after admission of wrongdoing under uncertainty as to whether he would be criminally prosecuted. This latter injury should not be underestimated. The criminal law has a strong concern for finality and repose, as reflected in the rules governing speedy trial and double jeopardy.

The S.E.C. is assigned the task of pursuing prompt injunctive and administrative remedies against broker/

dealer violations in order to protect the trading public and maintain the integrity of the securities markets.¹ A requirement that institution of a civil or administrative action constitutes a waiver of all subsequent criminal prosecution would "stultify enforcement of federal law." United States v. Kordel, 397 U.S. 1, 11 (1970).

In the present case the S.E.C. concern for protection of the investing public cannot be accorded much weight. Naftalin & Company traded only for its own account. The broker/dealers with whom Naftalin and his firm dealt were aware of his scheme from the October 27, 1969, meeting. The entry of the preliminary injunction against Naftalin & Company in this Court on November 4, 1969, and the attendant publicity in the investment community, provided further assurances against dealings by unwary parties with defendant or his firm.

¹The S.E.C.'s authority to seek injunctive relief is found in 15 U.S.C. § 77(t)(b):

"Whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the provisions of this subchapter, or of any rule or regulation prescribed under authority thereof, it may in its discretion, bring an action in any district court of the United States or United States court of any Territory, to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond. The Commission may transmit such evidence as may be available concerning such acts or practices to the Attorney General who may, in his discretion, institute the necessary criminal proceedings under this subchapter. Any such criminal proceeding may be brought either in the district wherein the transmittal of the prospectus or security complained of begins, or in the district wherein such prospectus or security is received."

The next to the last sentence of the subsection is of particular interest here. Although not without ambiguity, the words "such evidence as may be available" indicate a Congressional intent (1) that if it envisions possible criminal prosecution, the S.E.C. promptly refer the matter to the Justice Department, and (2) that the Justice Department continue the investigation. The S.E.C.'s delay of over four years in referring the present matter to the Justice Department violates the apparent intent of § 77(t)(b).

Conclusion

The Due Process Clause of the Fifth Amendment assures a person who has publicly admitted an incident of wrongdoing that the Government will act reasonably promptly to frame the matter for judicial resolution, thus facilitating a speedy trial, imposition and service of the penalty, and then the comfort of letting the incident rest. However innocent or inadvertent the delay in bringing this prosecution may have been, it was clearly without justification. The legitimate reasons which the S.E.C. has for delaying a criminal reference to the Justice Department have been "stretched to the breaking point"² in this matter. "[T]he accused's right to due process of law must prevail."³

Accordingly, IT IS HEREBY ORDERED:

That defendant's motion to dismiss the Indictment is granted.

August 8, 1975 .

/s/ Earl R. Larson
United States District Judge

²*United States v. Jackson, supra*, 504 F.2d at 340.
³*Ibid.*

UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA
FOURTH DIVISION

United States of America,

Plaintiff,

vs.

Neil T. Naftalin,

Defendant.

Order

No. 4-74-Crim. 73

Defendant has moved to dismiss the Indictment in its entirety, to dismiss Counts I—V of the Indictment, to dismiss Counts II—VIII of the Indictment, and to strike paragraphs 2 and 6 of Count I of the Indictment as surplusage.

Upon all the records, files, and proceedings herein,

IT IS HEREBY ORDERED:

1. That the Government produce for in camera inspection within 30 days of the date of this Order the documents requested in paragraph 14, subdivisions (a), (b), and (c), of Defendant's Motion for Discovery and Inspection. (A copy of paragraph 14 (a)-(c) is appended hereto.)

2. That judgment is reserved on defendant's motion to dismiss the Indictment because of delay in instituting prosecution.

3. That, except as provided in (2) above, defendant's motion to dismiss the Indictment in its entirety, to dismiss certain counts of the Indictment, and to strike certain allegations as surplusage are denied.

A-20

January 24, 1975.

/s/ Earl R. Larson
United States District Judge

Memorandum to Follow.

(Appendix to January 24, 1975 Order)

14. All records in the possession, custody or control of the Government, including specifically the SEC and the Federal Reserve Board, from which the following information can be determined:

(a) The date or dates on which, and the manner in which, any of the matters alleged in the Indictment relating to transactions of Naftalin & Co., Inc. or the activities of the defendant, during the period from July through October 1969, first came to the attention of the SEC, the Federal Reserve Board, the Department of Justice and any United States Attorney.

(b) The nature, extent and duration of the investigative activity undertaken by the SEC and the Federal Reserve Board relating to such matters, together with the dates and nature of any resulting actions taken or recommendations made.

(c) The nature and extent of the information generated by such investigative activities which was thereafter provided or made available to any other agency of the Government, including the Justice Department or any United States Attorney, together with the dates on which the information was provided or made available.

A-21

UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA
FOURTH DIVISION

United States of America,

Plaintiff,

vs.

Neil T. Naftalin,

Defendant.

Memorandum

No. 4-74-Crim. 73

The eight count Indictment charges defendant with violating § 17(a) (1) and (3) of the Securities Act of 1933, 15 U.S.C. § 77(q) (a) (1) and (3),¹ by defrauding certain

¹Section 17(a), 15 U.S.C. § 117(q)(a) provides:

"(a) It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser."

Willful violations of § 17(a) are made subject to criminal sanctions by § 24 of the Act, 15 U.S.C. § 77x. It reads:

"Any person who willfully violates any of the provisions of this subchapter, or the rules and regulations promulgated by the Com-

broker/dealers in connection with sales of stock made by the broker/dealers for the account of Naftalin & Co., Inc. Defendant has moved to dismiss the entire Indictment because (1) it does not state facts sufficient to constitute an offense against the United States; (2) it improperly alleges a single scheme to defraud under § 17(a)(1) in a multiplicity of counts; and (3) the intentional delay of four and one-half years from the commission of the alleged offenses until the return of the Indictment violates defendant's right to due process of law. Defendant has moved in the alternative for (4) dismissal of Counts I through V for lack of jurisdiction because they fail to allege a sufficient nexus with interstate commerce or the mails; and (5) for dismissal of Counts II through VIII for failure to state an offense because of the absence of the allegation that defendant acted "unlawfully." Additionally, defendant has moved that certain allegations of the Indictment be stricken as surplusage pursuant to Rule 7(d), Fed. R. Cr. P.

I. Facts Sufficient to Constitute an Offense—

The standards to be applied on a motion to dismiss an Indictment are set for in Russell v. United States, 369 U.S. 749 (1961). Russell requires that an Indictment contain the essential elements of the offense intended to be charged, adequately apprise the defendant of what he must be prepared to meet, and be sufficiently specific to indicate to what extent a conviction or acquittal upon it would be a defense to a future prosecution on a similar charge. 369 U.S. at 764-765.

mission under authority thereof, or any person who willfully, in a registration statement filed under this subchapter, makes any untrue statement of a material fact or omits to state any material fact required to be stated therein or necessary to make the statements therein not misleading, shall upon conviction be fined not more than \$5,000 or imprisoned not more than five years, or both."

Defendant first contends that § 17(a) is directed only to issuers, underwriters, dealers, and individuals associated with the issuers, underwriters or dealers. Defendant notes that the Eighth Circuit held in review of the Naftalin & Co. bankruptcy proceedings that Naftalin & Co. was not a broker/dealer. In re Naftalin & Co., Inc., 469 F.2d 1166 (8th Cir. 1972). Therefore, the argument concludes, defendant cannot be charged under § 17(a).

This argument must be rejected on two grounds. First, the Eighth Circuit's ruling that Naftalin & Co. was not a broker/dealer was for the purpose of determining at what point brokers should have bought-in in order to minimize their losses on stock which they had sold on account for Naftalin & Co., but which Naftalin & Co. never delivered. The Court's ruling does not imply that Naftalin & Co. is not to be considered a broker/dealer in other contexts. It does not negate the allegation in Count I, paragraph 2, of the Indictment that Naftalin & Co. was a registered broker/dealer.

Secondly, this Court interprets "any person" in § 17(a) according to its literal meaning. If Congress had wished to limit this section to issuers, underwriters, brokers, and their staffs, it would have expressly so provided. Instead, Congress drafted a broad remedy that would reach any kind of fraud in the offer or sale of securities. Defendant comes within the class defined by the words "any person."

Defendant next argues that the Indictment fails to state an offense because it does not allege that he defrauded "purchasers" of securities. Section 17(a) (3) is directed to any transaction which operates "as a fraud or deceit upon the purchaser." Defendant contends that it is implicit in each subdivision of § 17(a) that the fraud or misrepresenta-

tion affect a purchaser. Defendant's contention relies on Greater Iowa Corp. v. McLendon, 378 F.2d 783 (8th Cir. 1967), and can be summarized as follows:

Greater Iowa observed: ". . . § 5(a) and § 17(a) were designed primarily for the protection of investors who may purchase the unregistered or fraudulently sold shares. [Citation omitted.]" 378 F.2d at 790. It further stated: "It is our conclusion that private civil liability for violations of § 5(a) and § 17(a) exists only when the provisions of § 12 (15 U.S.C. § 77 1) are met." Id. Since § 12 provides that one who makes a misrepresentation in the sale of securities "shall be liable to the person purchasing such security from him," then § 17(a) applies only where a purchaser of securities has been defrauded.

This argument must be evaluated in light of the facts of Greater Iowa. The defendants in Greater Iowa had established a voting trust in an effort to gain control of the corporation. They issued certificates in the trust in exchange for shares of the corporation. The plaintiffs were the corporation, its directors, and certain shareholders. None of them had subscribed to the voting trust. The Court held that since they had not purchased trust certificates nor "had any semblance of legal privity" (378 F.2d at 790) with the defendants, they had no standing to bring a civil action under § 17(a).

The present case differs from Greater Iowa in that the brokers who are alleged to have been defrauded were in privity with defendant and come within the class to be protected by the statute. The Indictment charges that the brokers acted as agents of defendant in selling stocks for him

and suffered losses as a direct result of his scheme. In contrast, the plaintiffs in Greater Iowa suffered no direct loss. At most, they were threatened with an indirect loss, i.e., loss of control of the Greater Iowa Corporation. Greater Iowa does not require dismissal here because protection of brokers from fraudulent short sales schemes comes within the scope of § 17(a).

Reading § 17(a) literally, only subdivision (3) requires that the defrauded party be a purchaser. The acts specified in each subdivision are separate and distinct; each is an "allowable unit of prosecution." U.S. v. Amick, 439 F.2d 351 (7th Cir. 1971), cert. den. 404 U.S. 823, U.S. v. Birrell, 266 F. Supp. 539 (S.D.N.Y. 1967). Therefore, as to § 17(a) (1), the Indictment is not to be dismissed for failure to allege involvement of a purchaser.

The Government argues that it can satisfy the purchaser requirement of subdivision (3) by proving that the shares sold through H. S. Kipnis & Co. were bought for Kipnis' own account and, alternatively, by proving that defendant's failure to deliver the securities sold forced the other brokers to purchase securities in the market to cover the fraudulent sales. The first of these contentions must be rejected because the Indictment does not allege that Kipnis was a purchaser. "[A] court cannot permit a defendant to be tried on charges that are not made in the Indictment against him." Stirone v. United States, 361 U.S. 212, 217 (1960). The second contention must also be rejected in light of the principle that penal statutes are to be strictly construed. Subdivision (3) requires "a fraud or deceit upon the purchaser." The fraud charged was upon the brokers as selling agents. Regardless of the subsequent buy-in, a fraud upon a selling agent as to ownership of the securities sold cannot

fairly be construed as a fraud "upon the purchaser." Therefore, the Government will be limited at trial to proof of violations of § 17(a)(1).

II. Multiplicity of Counts

Defendant contends that the allowable unit of prosecution is the fraudulent course of conduct and that any particular use of the mails or telephone in connection with any particular sale is only a jurisdictional act and not a separate offense. Defendant seeks dismissal of the Indictment or, in the alternative, consolidation into a single count.

Federal Courts have expressed at least four different views as to the allowable unit of prosecution under § 17(a). These views, as summarized by the Seventh Circuit, are set out in a footnote.² This Court agrees with the Seventh Circuit's interpretation:

²*United States v. Amick*, 439 F.2d 351, 359 (7th Cir. 1971), *cert. den.* 404 U.S. 823, summarizes the different views:

"There is authority for the view (1) that, as is true of mail fraud, each separate use of the mails in the execution of a scheme to defraud in the sale of securities constitutes a separate offense;¹¹ (2) that each separate offer or sale transaction in which the proscribed conduct is employed and the mails used is the allowable unit;¹² (3) that where an indictment charges employment of proscribed conduct in separate transactions as separate counts, the determination whether there was one offense with several victims or a separate offense upon each victim can ordinarily not be made until proof is in;¹³ (4) that where an indictment alleges a scheme to defraud and a number of separate mailings and sales in separate counts, but fails to show that the crime charged in any one count differs from that charged in the others, all counts are to be consolidated and all but one dismissed as separate counts.¹⁴"

[FOOTNOTES]

"11. *Palmer v. United States* (10th Cir., 1956), 229 F.2d 861, 867, *cert. den.* 350 U.S. 996, 76 S.Ct. 546, 100 L.Ed. 861.

"[W]here an indictment charges employment of proscribed conduct in separate transactions as separate counts, the determination whether there was one offense with several victims or a separate offense upon each victim can ordinarily not be made until proof is in." *U.S. v. Amick*, 439 F.2d 351, 359 (7th Cir. 1971), *cert. den.* 404 U.S. 823.

The counts of this Indictment charge not only separate mailings but also separate sales. The Court cannot conclude as a matter of law that the Government will be unable to prove separate and distinct offenses. Therefore, defendant's motion must be denied at this time. It may be renewed at the close of trial.

III. Delay Prior to Indictment—

The sales on which the Indictment is based are alleged to have taken place in August 1969. Defendant states that the Securities and Exchange Commission began an investigation of these sales in October 1969; that the SEC ascertained the essential facts of the present Indictment no later than November or December 1969; that before this Indictment was sought, the SEC participated in a civil ac-

"12. *Sanders v. United States* (5th Cir., 1969), 415 F.2d 621, 626; *United States v. Saporta* (E.D.N.Y., 1967), 270 F. Supp. 183, 186. In this circuit it has been said that 'the government must show some impact of the scheme on the investor and that the mails were used in those instances where the impact occurred.' *United States v. Schaefer* (7th Cir., 1962), 299 F.2d 625, 629.

"13. *United States v. Birrell* (S.D.N.Y., 1967), 266 F. Supp. 539, 544.

"14. *United States v. Hughes* (S.D.N.Y., 1961), 195 F. Supp. 795, 798."

ion,³ a bankruptcy appeal,⁴ and an administrative proceeding,⁵ all of which concerned the same facts alleged in the Indictment. Defendant argues that the SEC's involvement in these non-criminal proceedings over a four and one-half year period prior to the Indictment has violated defendant's Fifth Amendment guarantee of due process of law.

To support these claims, defendant sought in May 1974 (1) discovery of correspondence between brokers or the New York Stock Exchange and the SEC, the Federal Reserve Board, or the Justice Department concerning the subject matter of the present Indictment; and (2) discovery of internal documents of the SEC, Federal Reserve Board, and the Justice Department concerning investigation and institution of prosecution in the present case. The Magistrate denied these requests for discovery in his Order of June 4, 1974. That denial was based on United States v. Emory, 468 F.2d 1017 (8th Cir. 1972), in which the Court of Appeals ruled that a showing of substantial prejudice beyond a bare claim of faded memories was essential to establishing a violation of due process through pre-Indictment delay. This Court summarily affirmed the Magistrate's Order in its Order of July 29, 1974.

Subsequent to the July 29 Order, defendant submitted an affidavit stating that he would be prejudiced by the delay because of the death on April 1, 1972, of John M. Dryfoos, a senior partner in a New York brokerage firm. According to the affidavit, Dryfoos would have testified that Naftalin & Co. bought substantial amounts of securities from his

³*SEC v. Naftalin & Co.*, No. 4-69-Civil 385 (D. Minn. 1969).

⁴*In re Naftalin & Co.*, 469 F.2d 1166 (8th Cir. 1972).

⁵*In re Naftalin & Co.*, SEC File No. 3-3277 (1971).

firm in 1968 and 1969; that on many occasions immediate delivery of the securities was provided; and that Naftalin & Co. maintained its account in good standing. Defendant apparently contends that Dryfoos' testimony would be relevant to the issue of intent to defraud. Assuming for the purpose of the present motion that Dryfoos' testimony would have been relevant, the Court finds that the dealings about which Dryfoos would have testified can be established from the records of the Naftalin and Dryfoos brokerage firms. (See Government's Brief at p. 3.) The Court again concludes that defendant has failed to demonstrate substantial prejudice under the Emory standard.

Since the present motions were taken under advisement in September, two decisions have been handed down which suggest reconsideration of the denial of the discovery requests. In United States v. Jackson, No. 74-1045 (8th Cir.) decided September 13, 1974, the Court of Appeals by Judge Heaney rejected a claim that a pre-Indictment delay had violated due process. The Court in Jackson relaxed the Emory requirement that an affirmative showing of substantial prejudice was essential for a finding of a violation of due process:

"It is often said that unreasonable delay must coincide with prejudice before the due process clause requires reversal and hence many courts after finding lack of prejudice, refuse to consider the reasons for delay

"Since we prefer to view the due process claim as one involving a balancing process, we hesitate to say that prejudice could never be presumed in an outrageous

case of unjustified delay." United States v. Jackson, supra, slip op. at 3-4 n.2 (citations omitted).

In United States v. U.S. Gypsum Co., 43 U.S.L.W. 2194 (W.D. Pa. Oct. 21, 1974), the Court ordered the Government to produce all internal memoranda from a 13 year period relevant to the claim that the Government had intentionally delayed prosecution on criminal antitrust charges in order to impair the defense. "[R]ecognizing that proof of this [intentional delay] could be found only in the Government's files, if, indeed, it existed at all," the Court ordered production of "all material which might have any bearing on the point [defendants] wish to prove." 43 U.S.L.W. at 2195. After in camera examination of "a mountain" of Antitrust Division and FTC internal memoranda, the Court concluded that the documents exonerated the prosecution of all claims of impropriety.

Under Jackson an affirmative showing of substantial prejudice is not essential for a finding of a due process violation (1) in a case where the Government has engaged in intentional delay in order to gain a tactical advantage or (2) in other outrageous cases of unjustified delay. The Eighth Circuit in an earlier order in Jackson had remanded the case with instructions for the District Court to make findings as to the reasons for the eleven month delay between the offense and the Indictment. In the present case, 55 months passed between the time the brokers became aware of the allegedly fraudulent transactions and the bringing of the Indictment. On the basis of prior proceedings against Naftalin & Co. arising out of the same transactions, defendant suggests that the Government was aware of the

facts alleged in the Indictment as much as four and one-half years before the Indictment was brought. The Government has not disputed this inference nor offered any justification for the apparent delay in instituting prosecution.

The appropriate procedure for resolving claims of unjustified pre-Indictment delay and of intentional delay for tactical advantage is that followed in U.S. Gypsum. Faced with similar defense motions arising out of a five year delay between initial investigation and presentation to the grand jury, the Court in U.S. Gypsum ordered production of all relevant Government documents for in camera inspection. Subsequently, the Court allowed defense inspection of the documents. This Court will, therefore, order production of certain Government documents for in camera inspection and reserve decision until after the inspection on whether the documents will be disclosed to the defense and on whether an evidentiary hearing will be required. The documents to be produced are those requested in paragraph 14, subdivisions (a), (b), and (c), of defendant's Motion for Discovery and Inspection, filed May 17, 1974:

"14. All records in the possession, custody or control of the Government, including specifically the SEC and the Federal Reserve Board, from which the following information can be determined:

(a) The date or dates on which, and the manner in which, any of the matters alleged in the Indictment relating to transactions of Naftalin & Co. Inc., or the activities of the defendant, during the period from July through October 1969, first

came to the attention of the SEC, the Federal Reserve Board, the Department of Justice and any United States Attorney.

(b) The nature, extent and duration of the investigative activity undertaken by the SEC and the Federal Reserve Board relating to such matters, together with the dates and nature of any resulting actions taken or recommendations made.

(c) The nature and extent of the information generated by such investigative activities which was thereafter provided or made available to any other agency of the Government, including the Justice Department or any United States Attorney, together with the dates on which the information was provided or made available."

IV. Counts I-V: Jurisdictional Act

Defendant contends that the jurisdictional requirement of use of the mails or other instrumentalities of commerce is not satisfied by the allegations that the defrauded brokers used the mails to send defendant confirmation of his sales. Defendant maintains that these mailings are so remote from the alleged scheme that they do not support Federal jurisdiction. In support of this contention, defendant cites Getchell v. United States, 282 F. 2d 681 (5th Cir. 1960). In Getchell, the mailing upon which jurisdiction under §17(a) was alleged concerned the form in which subscribers wished their certificates to be made out. It contained no offers, promises, or representations. The Fifth Circuit reversed three convictions based on this mail-

ing. Defendant interprets these reversals as signifying that a conviction under §17(a) requires that the mails be employed directly in the scheme to defraud. Although not without ambiguity, the result in Getchell appears to be based on the Government's failure to prove the particular use of the mails set out in the Indictment. 282 F. 2d at 684. The Court noted that the "question of statutory construction need not be decided in this case." Id. This Court does not find Getchell persuasive authority for defendant's contention.

The Government cites United States v. Cashin, 281 F. 2d 669 (2nd Cir. 1960), as supporting jurisdiction in the present case. In affirming a conviction under §17(a), Cashin observed (281 F. 2d at 674):

"No claim is made that the fraudulent matter was mailed or even that the mailings alleged were necessary to the execution of the unlawful scheme. In fact, the only alleged use of the mails was to confirm purchases already induced by the defendant's deceit."

In Cashin the defendant was charged with fraud in the sale of securities and jurisdiction was based on his mailing of the confirmations of the sales. In the present case, defendant Naftalin did not mail confirmations but received confirmations mailed by the brokers. The Indictment charges that defendant "caused" these confirmations to be mailed. The connection between the scheme and the use of the mails is weaker in the present case than in Cashin.

The Court of Appeals for the Eighth Circuit has held that the jurisdictional act requirement of §17(a) is to be construed broadly. Little v. United States, 331 F. 2d 287

(8th Cir. 1964), cert. den. 379 U.S. 834, sustained a conviction under §17(a) in which the jurisdictional act was defendant's deposit of the duped investors' checks in a Memphis bank with knowledge that the checks would move through interstate commerce to the Federal Reserve Bank in St. Louis. In holding that defendant "caused" the checks to move in interstate commerce, the Court relied on a Supreme Court decision concerning mail fraud:

"Where one does an act with knowledge that the use of the mails will follow in the ordinary course of business, or where such use can reasonably be foreseen, even though not actually intended, then he 'causes' the mails to be used.'" Pereira v. United States, 347 U.S. 1, 8-9 (1954) quoted in Little, supra, at 293.

Little noted that "Congress intended to assert its full constitutional power" in enacting the jurisdictional provisions of the Securities Act of 1933, and that a prosecution under §17(a) may be sustained if the mail is "used in employing the scheme however incidental the mailing may be. [Citation omitted.]" 331 F. 2d 292-293.

As an experienced trader in securities, defendant would have known that a confirmation by mail would follow each of the sales listed in the Indictment. The Indictment adequately alleges that defendant "caused" the confirmations to be mailed. These confirmations are incidental to the scheme charged and, under Little, will support jurisdiction under § 17(a).

V. "Unlawfully" as Necessary Element of Counts II through VIII

Defendant contends that since § 17(a) uses the word "unlawful," an indictment thereunder is fatally defective unless it alleges that the defendant acted "unlawfully." This contention is without merit. The section reads: "It shall be unlawful for any person" "Unlawful" is not an element of the proscribed conduct; it only introduces what is proscribed. The Court holds it is not necessary for the Indictment to allege that defendant acted "unlawfully."

VI. Surplusage

Defendant requests that two portions of Count I in the Indictment be stricken as surplusage: (1) the allegation in paragraph 2 that Naftalin & Co. was a registered broker/dealer and a member of the National Association of Securities Dealers; (2) the allegations in paragraph 6 that defendant made false and misleading statements to the selling brokers after the due dates for delivery of the stock sold. In support of the first request, defendant relies on the Eighth Circuit's treatment of Naftalin & Co. as an ordinary investor in In re Naftalin, 469 F. 2d 1166 (8th Cir. 1972). As discussed in Part I of this memorandum, this Court does not read the characterization of Naftalin & Co. by the Eighth Circuit as applying outside the context of Regulation T. Therefore, the Government is not foreclosed from proving that Naftalin & Co. was a broker/dealer. Such proof would be relevant to defendant's understanding of securities trading practices and, thereby, to defendant's intent. The allegation is not surplusage.

Defendant contends that subsequent misrepresentations

are not material to a violation of § 17(a) because the section is directed only to fraudulent schemes "in the offer and sale of securities." The Government argues that these misrepresentations were part of the on-going scheme to defraud the selling brokers. It cites Walters v. United States, 256 F. 2d 840 (9th Cir. 1958), cert. den. 358 U.S. 833, in which the Ninth Circuit approved the giving of the following instructions by the District Court in a § 17(a) prosecution:

"A scheme to defraud may well include later efforts to avoid detection of the fraud. Avoidance of detection and prevention of recovery of property fraudulently obtained may be a material part of an illegal scheme." 256 F. 2d at 843.

By negative implication, the quoted passage suggests that an effort to avoid detection will not in every situation be deemed a material part of an illegal scheme. It is necessary to view the total scheme charged to determine if the subsequent acts are so related as to be part of the offense.

Count I, paragraph 5, of the present Indictment alleges that defendant sought through his scheme to effect short sales of the stocks sold. The inference which follows from paragraph 5 is that defendant would at a later date close out the short sales by buying and delivering the necessary stock certificates. The closing out of the short sales is part of the total scheme. The statements alleged in paragraph 6 were intended to placate the selling brokers until defendant could complete his scheme by buying and delivering the stock certificates. The Court concludes that these statements are a material part of the total scheme with which

defendant is charged. The motion to strike paragraph 6 of Count I must be denied.

January 28, 1975.

/s/ Earl R. Larson

United States District Judge
